DELHI HIGH COURT

Income-Tax Officer

Vs.

Narula Finance P. Ltd. (Delhi)

Company Application No. 115 of 1978 in C.P. No. 84 of 1968

(D.K. Kapur, J.)

8.5.1978

JUDGMENT

D.K. Kapur, J.

1. The subject-matter of this application has already been dealt with by me in a previous reported case, *In Re National Conduits (P.) Ltd.,* [1]

2. The facts of the present case are that there is a company, M/s. Narula Finance (P.) Ltd. in liquidation ; the winding-up order was passed on 20th December, 1968 ; since then the winding-up proceedings have resulted in the recovery of some assets. According to the official liquidator, who is present, a list of creditors has been settled in 1977 and realizations have also been made as far as possible. By this application, the Income-tax Officer and others seek to get the leave of the court under Section 446 of the Companies Act, 1956, to recover the outstanding tax demands against the company, by taking such proceedings as may be available under the Income-tax Act, 1961. It is quite obvious that the application seeks to take certain coercive steps under the Income-tax Act, 1961, which leads to a supposition that the income-tax authorities want to act outside the Companies Act. To understand the legal background of the matter, it is enough to refer to the above-mentioned judgment delivered by myself which is based on some of the leading decisions of the Supreme Court and the Federal Court on the subject. The legal position is that in the matter of recoveries from a company in liquidation, the income-tax authorities stand in the same position as any other creditor. The payments to such creditors have to be made in accordance with sections 528 and 529 of the Companies Act. These sections provide that the insolvency law will govern payments to creditors of insolvent companies and payments will be made on

proof of debts. Thus, if the income-tax authorities want to recover anything from the assets of an insolvent company, they have to prove the debt before the court and will be paid pari passu along with other creditors. The income-tax authority or income-tax dues have no special advantage or priority. The entire legal position has been fully explained by the Federal Court in *Governor-General in Council v. Shiromani Sugar Mills Ltd.,* [1]wherein it was held that :

".....the Crown is bound by the provisions of the Companies Act, and is bound, in regard to the provisions relating to the liquidation of companies, to a statutory scheme of administration wherein the prerogative right of the Crown to priority no longer exists. The Crown is accordingly not entitled to any prerogative, priority, or preferential rights or treatment, in payment of its claims, save those expressly conferred and limited by the Act itself, in particular by Section 230 and Sub-section (2) of Section

232. "(Reference is to the Act of 1913).

3. The question for consideration is whether there has been any change in the legal position since then, and I have come to the considered conclusion that there has been no change, and I have previously so held in the judgment referred to earlier.

4. This view was also accepted by the Supreme Court in a judgment also referred to in that previous decision, i.e., *S. V. Kondaskar v. V. M. Deshpande,* [2] In this judgment (which was concerned with the question whether income-tax assessment proceedings were also subject to Section 446 and hence under the control of the company court), the Supreme Court observed as follows :

"We have not been shown any principle on which the liquidation court should be vested with the power to stop assessment proceedings for determining the amount of tax payable by the company which is being wound up. The liquidation court would have full power to scrutinize the claim of the revenue after income-tax has been determined and its payment demanded from the liquidator. It would be open to the liquidation court then to decide how far under the law the amount of income-tax determined by the department should be accepted as a lawful liability on the funds of the company in liquidation. At that stage, the winding-up court can fully safeguard the interests of the company and its creditors under the Act."

5. Thus, the law laid down by the Supreme Court is to the effect that it is the liquidation court which has to scrutinize the claims of the income-tax department and has to deal with them, as indeed, it has to deal with claims by other creditors. It is, however, urged by the learned counsel for the petitioner that the Income-tax Act was amended in 1961 and now it is a complete code by which income-tax can be recovered and, being a complete code, means that the recovery of tax outstanding can be made outside the jurisdiction of the liquidation court. As the above judgment was given in 1972, 11 years after the Income-tax Act was passed, I am unable to accept that any change in the Income-tax Act has altered the legal position. I am in any case bound by the Supreme Court's declaration of the law.

6. It is no doubt true that if there is a special procedure for dealing with particular types of claims such as income-tax assessments of claims under special laws, etc., then the assessment of that tax or computation of penalties, etc., payable under that Act or assessment or reassessment proceedings, etc., have to take place under that Act; in other cases, special proceedings have to take place before the Tribunals denominated for this purpose by the law in question. The High Court as the company court, which is the alternative court under the Companies Act as per Section 446, cannot possibly deal with subjects like assessment, reassessment or appeals against assessments or reassessments, etc. The whole scheme concerning the computation of income-tax is contained in the Income-tax Act. Not only is this in accordance with logic and reason, but it was also so held by the Supreme Court in the above-mentioned judgment. Once the income-tax has been assessed and has become a money claim then it differs in no way from any other money claim against the company. All such money claims have necessarily to be dealt with on the basis that the company under the control of the* official liquidator has to meet these claims and also the claims of other creditors. At that stage, these claims have to be adjusted inter se. If the company in liquidation is solvent then there is no difficulty; if the company is insolvent then insolvency rules have to be applied.

7. The principle behind the Companies Act is indeed an equitable principle. The law from times immemorial has been that when a person becomes bankrupt then a trust created by equity or statute, takes the assets of the bankrupt into control and this "trustee in bankruptcy" deals with the assets so as to adjust them between the various creditors. This equitable jurisdiction is

now to be found not only in the English law of bankruptcy but also in the Indian law of insolvency, wherein either the official receiver or the official assignee takes the place of the "trustee in bankruptcy ". In the case of companies, it is the liquidator or any other similar person appointed by the court who takes charge of an insolvent company. The principles applicable to such companies are exactly those applicable to the ordinary insolvents. If the assets are sufficient to meet all the creditors then all the creditors can be paid off. If the assets are insufficient, then the insolvency rules regarding payment of priority claims and the adjustment of the balance between other debtors pari pussu have to be applied. This adjustment ensures the equitable distribution of the assets amongst the various creditors. Unless a priority can be spelt out in express terms from a statutory provision or is inherent or can be inferred, there is no priority. Here the question is what is the priority available with the income-tax department?

8. I have already dealt with the Federal Court judgment and the Supreme Court judgment to show that no priority has been accepted as being applicable to income-tax dues after a company has gone into liquidation. It now remains to be seen whether any such priority has been created in some other way. It is urged by the learned counsel for the applicant that such a priority has in fact been created by the enactment of Section 178 of the Income-tax Act, 1961, which provides that when a company has gone into liquidation, the liquidator shall give notice of his appointment within thirty days to the Income-tax Officer and thereafter, within three months, the Income-tax Officer will inform the liquidator concerned of the income-tax liability then due or likely to be due thereafter. There is a further provision in the section that the liquidator has to keep such amount apart. The question for consideration is does this mean that the Income-tax Officer by passing an order under Section 178 can create a priority in respect of income-tax dues which is not provided for in any other law. In my opinion, this section does not create any priority and I now proceed to set out my reasons for this view.

9. The basic question involved in the enactment of Section 178 is the protection of the assets of the company in winding up for the purpose of payment of income-tax. The section has been introduced to meet a particular danger which arises when a company goes into liquidation. There is a danger that the liquidator may pay off all the other creditors or do away with the assets

or property and nothing may be left over for payment of income-tax. To meet this possibility, the Income-tax Officer issues an order to the official liquidator or other liquidator, to the effect that a particular amount specified by him is to be kept apart and is not to be utilized. The object is that the amount covered by the order is protected, in the sense that it cannot be utilized by the official liquidator for other objects. This does not mean that the amount which has been kept apart has never to be adjusted under the insolvency rules and has necessarily to be paid as income-tax dues. Naturally, the real amount to be paid has to be calculated after the making of the necessary adjustments under Section 528, 529 or 530 of the Companies Act, 1956. The order under Section 178 is a purely procedural order protecting the amount, but the computation of the real amount payable requires judicial determination. I would like to particularly say why this is so. For illustrating the question, I would like to frame certain examples. For instance, suppose the company has assets amounting to Rs. 2 lakhs when ordered to be wound up, and the income-tax dues are Rs. 50,000. It can also be assumed that the other debts are, say, Rs. 70,000. Then there is no difficulty of keeping the sum of Rs. 50,000 because that amount is available. Now let me assume that the other debts of the company are say three lakhs. Even then, there is no difficulty in keeping Rs. 50,000 out of the assets of Rs. 2 lakhs but the actual payment to be made to the Income-tax Officer will depend on the result of determining the priorities between the Income-tax Officer's claim and the other debts. The part passu amount payable will in the end be paid on a percentage basis. Thus, the actual amount paid to the Income-tax Officer may be less than the claim of Rs. 50,000. The settlement of the actual dividend and the retention of Rs. 50,000 are two independent processes and there is nothing in Section 178 to suggest that anything in excess of the dividend settled in the liquidation proceedings is payable for income-tax purposes. If the legislature wanted to say that the full amount would be payable there was nothing to prevent it saying so while enacting Section 178. An omission in the section cannot be provided by legal submission or argument.

10. Now, I take another example, suppose the assets of the company are Rs. 50,000 and the Income-tax Officer's claim is Rs. 2,00,000. Obviously, the liquidator cannot keep apart Rs. 2 lakhs out of an amount of Rs. 50,000. He, therefore, cannot comply with the order. Section 178 does not deal with such circumstances, and merely states that if the liquidator does not keep Rs. 2 lakhs

he is personally liable for the remaining balance. Obviously, this is not a reasonable way to read the section. The liquidator cannot retain anything he does not have. He cannot, therefore, keep more than Rs. 50,000. Even after retaining this amount, the actual amount to be paid is the dividend and not the amount retained. The court has no power to alter the section.

11. It is obvious from this analysis that Section 178 does not provide the answer as to how adjustments have to be made between creditors. Reference has to be made to sections 528 to 530 of the Companies Act for this purpose. The analysis need not be amplified any further.

12. In the present case, the position is quite a simple one. The company went into liquidation in the year 1968. The realization of the assets has not been very much compared to the income-tax claims of Rs. 28 lakhs which have now been made. There is no possible way in which the income-tax claims can be realized as all debts and claims are now barred by time, and the better course would be to treat the income-tax amount as non-realizable. It is rather strange that a small insolvent company should result in such large income-tax claims. The background of the case is that when the company closed down, I am told that it was discovered that the company in liquidation was doing some business in hundies which led to an assumption that it had made large profits. This is the reason why the income-tax claim for this company has come to Rs. 28 lakhs while the assets are only Rs. 1 lakh. Naturally, the way in which these assets have been dealt are unknown to the official liquidator but there must be a lot of material available with the Income-tax Officer, as to how the hidden profits of the company have been secreted. It, therefore, becomes particularly important to discover whether in fact the additional Rs. 27 lakhs exists and if so where it exists. It also appears that part of the claim of Rs. 28 lakhs is really by way of penalty, interest, etc., which are due for non-payment of tax or the late filing of returns. Still, the official liquidator is appointed by the Central Government. The Income-tax Officer is also an officer of the Central Government. I hope they can work in cooperation with each other to get the best results. I have, therefore, tried to find out some way in which the powers which the Income-tax Officer has can be utilized by the official liquidator or by them jointly. I find that in this case also, the claims are belated by about 10 years because the company has been in winding-up for 10 years. If there is any realizable assets of the company which has not so far been realized, all steps should be taken to

get such realizations. I feel that if more particulars are forthcoming on record regarding the assets they should be supplied by the Income-tax Officer who can be examined under Section 477 of the Companies Act, 1956, in private to supply necessary information to the court, or he may supply the information himself. In any case, the official liquidator should call for information from the Income-tax Officer concerning any other assets he may know about.

13. Though I have made an analysis of Section 178 of the Income-tax Act above, I must also observe that the same was not really necessary in this case as there is no mention of any direction having been given under that section in the statement of facts contained in the application. In fact, it is common ground that the present income-tax claims which are around Rs. 28 lakhs did not exist at the time the company went into liquidation. It also appears that as soon as the company closed down due to losses, etc., the Income-tax Officer depending largely on facts known only to him, started making heavy assessments, apparently on the basis that the company must be making heavy profits. It is pointless to make any comments on the wisdom of such a procedure ; ordinarily, logic and reason would have indicated that a company which has closed down due to inability to pay debts, could not be making profits, but possibly such logic has no place in taxation proceedings. Unfortunately, due to the Supreme Court's declaration of law in Kondaskar's case the winding-up court has no control on the assessment proceedings and has no power to even stay such proceedings thus leading to the piquant situation now appearing, of an insolvent company being on paper also the recipient of heavy profits, which are untraceable.

14. I may here say that there are two reported cases taking different views of Section 178 of the Income-tax Act, 1961. The Andhra Pradesh High Court has held in *Income-tax Officer v. Official Liquidator,* [3] that this section gives priority to income-tax dues even if there is no order under Section 178. The Gujarat High Court has taken the opposite view in *Baroda Board & Paper Mills Ltd. v. Income-tax Officer,* [4] Needless to say, my own conclusion, as expressed above, is that even if there were a direction under that section, no priority results? I may mention here that the Supreme Court's view, the Federal Court's view and even this court's view as expressed in my own earlier judgment were apparently not cited before the Andhra Pradesh High Court.

15. In these circumstances, it now remains for me to consider whether leave

should be given to the Tax Recovery Officer or the other applicants to make recoveries outside the liquidation proceedings. Although a reference has been made to Sections 222 and 226 of the Income-tax Act, 1961, to urge that the taxation authorities have very many powers to make recoveries, which are not available to the official liquidator, I must come to the conclusion that this submission is illusory. The official liquidator's powers to get a summary judgment from the company court either under Section 446 or 477 of the Companies Act, 1956, has no parallel in" the Income-tax Act. The great power of the company court to take possession of the assets under Section 468 has no equivalent except under the Insolvency Act. The availability of all the courts in India for execution purposes as per Sections 634 and 635 are also unique. I, therefore, find that very little purpose would be served in giving leave to the applicants. Particularly, it may be noticed that this company was ordered to be wound up in 1968 ; ten years have passed ; hence all claims from debtors are now time-barred. No new recovery can now be made. However, if any assets are traceable, the official liquidator may be informed by the taxation authorities in which case recovery can be made under Section 468, 477 or any other available power. With these observations, I dismiss this application but forbear to pass, any order regarding costs.

.Cases Referred.

1.(1946) 14 ITR 248, 254, 255 : 16 Comp Cas 71, 76, 77 : AIR 1946 FC 16,

2. (1972) 83 ITR 685, 699 : 42 Comp Cas 168, 181.

3. (1975) 101 ITR 470 : (1976) 46 Comp Cas 46,

4. (1976) 102 ITR 153 : 46 Comp Cas 25.